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No. 96

IN THE

Supreme Court of the United States

October Term, 1962

UNITED STATES,

Petitioner,

v.

BUFFALO SAVINGS BANK.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

ANSWERING BRIEF OF RESPONDENT TO REPLY BRIEF FOR THE UNITED STATES

JOHN HORACE LITTLE,
Attorney for Buffalo Savings Bank,
545 Main Street,
Buffalo 3, New York.

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I.

The Reply Brief of the United States contains erroneous and misleading statements which must be corrected.

Respondent wishes to answer the Government's Reply Brief because of some erroneous and misleading statements therein.

The first of these appears on page 1 of the Reply Brief and is as follows:

"perfected federal and state tax liens are of equal dignity".

Federal tax liens and local real estate tax liens are so different that to say they are of equal dignity is meaningless. The New York Court of Appeals in its opinion herein stated: "The local Government lien is not a levy against the mortagor, but against the land * * *" (R. 76). *Amicus Curiae* in its Brief at page 6 puts it this way: "(state) taxes are levied upon the land itself, without regard to the separate interests therein." The point of this is not that state taxes are liens on specific properties, while federal tax liens are general liens on all the property of the debtor, but that as to any given property of the tax debtor the state tax is a lien on all the interests in that property including that of the owner, any mortgagee, and any judgment creditor (Paddell vs. City of New York, 211 U. S. 446, 450); while the federal tax lien attaches only to the interest of the taxpayer owner in that property at the time the federal tax lien is filed. This interest of the taxpayer owner can and does vary according to his previous contractual dealings with that property.

Chief Judge Lufbard of the Second Circuit recognized this in City of New York vs. United States, 283 F. 2d 829 (1960), when, in discussing what property rights to which a federal tax lien might attach after the taxpayer debtor had made a general assignment for the benefit of creditors under the New York Debtor and Creditor Law, he said at page 832:

> "The Section 6321 lien attaches only to the extent of the taxpayer's property interest, United States v. Burgo, 3 Cir., 1949, 175 F. 2d 196, and is not a proper basis for a levy on contingent rights before they come into being. United States v. Long Island Drug Co., 2 Cir., 1940, 115 F. 2d 983. Thus, the property, after

it had been assigned by the taxpayer, could not be subjected to the government's lien."

In United States v. Cox, 119 Fed. Supp. 147, District Court, Northern District of Georgia (1953), a federal tax lien was filed after the execution of a mortgage in the Georgia form of a deed of trust. The Court at page 150 said:

> "The taxpayer having executed the deed to secure a debt, which deed was entered of record before the recording of the notice of lien of the United States, this Court must determine what, if any, interest the taxpayer retained in the property after making the deed, and consequently what interest, if any, the taxpayer had at the time of the record of the government's claim of lien."

Circuit Judge Hamilton in Metropolitan Life Ins. Co. v. United States, Sixth Circuit, 107 F. 2d 311 (1939), Cert. denied 310 U. S. 630, at page 313 defines the property interest of the taxpayer to which the Federal lien attaches as follows:

> "The lien of the government attaches to all of the property in possession of the taxpayer to the extent of his interest in and rights thereto, depending upon contracts and unexecuted instruments . . ."

The holding in this 1939 case, that a federal tax lien cannot be wiped out by a non-judicial sale pursuant to a power of sale contained in the mortgage, was specifically reversed by this Court in Bank of America National Trust and Savings Association vs. United States, 363 U. S. 237 (1960). Therefore, the dissenting opinion of Circuit Judge Arant in Metropolitan Life Ins. Co. vs. United States (*supra*) is of particular interest. At page 314, he says:

> "The lien of the United States involved herein was based upon an income tax, not a property tax; and attached only to 'property and rights to property, whether real or personal, belonging to' the tax debtor.

R. S. Sec. 3186, U. S. C., title 26, Sec. 1560, 26 U. S. C. A. Section 1560."

* * *

"The conclusion is inescapable, therefore, that the tax lien attaches only to the destructible interest that remains in a mortgagor after execution of a mortgage with a power of sale."

and at page 315:

"No attribute of sovereignty of the United States can increase the interest of a property owner. See Trust Co. of Texas v. United States, D. C., 3 F. Supp. 683."

2. In the light of all the foregoing, the Government's statement at page 2 of its Reply Brief, as follows:

"Under New York law, the mortgagor is the owner of the fee, subject only to the mortgage; and, as this Court said in United States vs. Brosnan, 363 U. S. 237, 241, the property interest of the mortgagor to which the federal lien can attach is not diminished by the particular means of enforcement possessed by a prior mortgagee."

must be examined. Without question, regarding the legal status of mortgages, New York is a so called lien state. In New York a mortgagor does not convey his fee interest to the mortgagee subject to defeasance upon payment of the debt secured. All he does is give the mortgagee a lien on the mortgaged property. But by the creation of this lien on his property he has reduced his ownership rights in the property. Before his title was unencumbered. Now it is encumbered. Furthermore, it is encumbered exactly to the extent provided by the terms of that mortgage. He has assigned conveyed mortgaged certain ownership rights in his property beyond the reach of the federal lien. In the case at bar the mortgage (as do all New York mortgages) provided that on a default, the mortgagee "was thereby empowered to sell the mortgaged premises according to law". (Original 60, point 32). The

law referred to (Secs. 1082 and 1087 of the New York Civil Practice Act) was thereby made a part of the mortgage terms, and the mortgagor thereby and at that time reduced his ownership rights in the mortgaged premises by giving to the mortgagee the right, conferred by these Civil Practice Act provisions, to require the payment of real estate taxes as an expense of sale, before any surplus moneys (as defined by Section 1082 of the New York Civil Practice Act) are created, to which junior encumbrancers (including the United States under its tax lien), and in the absence of any junior encumbrancers, the owner, is entitled. This right is a property right, and not a mere "particular means of enforcement possessed by a prior mortgagee." It enables the mortgagee to give good title to the purchaser on the sale.

This has been the law in New York since 1880 (See Main Brief). It can hardly be called an attempt by a state legislature through the characterization of a claim to control the priority of federal liens. The New York Court of Appeals in Wesselman v. Engel Company, 309 N. Y. 27 (1955) in discussing the applicability of this Section 1087 to an independent private guarantee of "expenses of foreclosure" said at page 30:

> "It is said that the aforementioned taxes and assessments are 'expenses of foreclosure of said mortgage' within the terms of said guarantee, and reliance for this holding is placed on section 1087 of the Civil Practice Act. But that statute says nothing about '*expenses of foreclosure*'. It merely provides that taxes and assessments '*which are liens upon the property sold* • • •' are deemed expenses of the *sale* within the meaning of that expression as used in any provision of *this article*.' (Emphasis supplied.) The purpose of this section is to protect, not the mortgagee, but the purchaser on a foreclosure sale, who is entitled to a clear title (Moyer v. Wilson, 248 App. Div. 5, Mod. 276 N. Y. 161; Equitable Life Assur. Soc. v. Toplitz,

> 69 Misc. 457, Affd. 143 App. Div. 929; Coudert v. Huerstel, 60 App. Div. 83). In short, it directs the referee to pay out of the proceeds of the sale *unpaid* taxes and assessments so that he can give title free of such then existing liens."

This established New York law has created property rights long relied on by New York mortgagees. The question before this Court now is, must it (the law set forth in the statutes—Sections 1082 and 1087 New York Civil Practice Act) be stricken down because the federal tax collector finds it incidentally impedes him in collecting his taxes, not from the taxpayer, but from the mortgagee of the taxpayer's property, the latter having been referred to by Congress when adopting the predecessor to Section 2410 U. S. C. 28, as "being a person to whom the Government would in no event look for its (the federal tax) payment" (Main Brief Page 18).

3. Respondent respectfully contends that the fact the Government and the City of New Britain may have discussed in their briefs in U. S. vs. City of New Britain, 347 U. S. 81, the effect on mortgagees and judgment creditors of this Court's decision in that case, does not alter the fact that the mortgagee and judgment creditor were not in Court when the argument was made. It is still a correct statement to say that they, the persons most directly involved, did not have an opportunity to state their case. And it is equally true that this Court in that case was concerned only with the relative priority of federal and state taxes in regard to the surplus and not with the rights of mortgagees and judgment creditors.

The dissenting opinion of Mr. Justice Whittaker in United States vs. Rail Construction Company Inc., 355 U. S. 587 (1958), in which he was joined by Mr. Justice Douglas, Mr. Justice Burton and Mr. Justice Harlan, expressly says

that they (the four dissenting justices) did not think the rights of mortgagees and judgment creditors were considered by the Court in New Britain. At page 590 of this dissent, it is said:

> "The controversy in New Britain was over that portion of the proceeds of a real estate mortgage foreclosure sale which exceeded the amount of the mortgage."

and at page 591, it is said:

> "We think it is not only apparent that Section 3672(a) had no application to that case but also that the Court expressly so declared."

and at page 592, it is said:

> "* * * in New Britain, this Court was not dealing with any mortgage, pledge or other contractual lien, or with any question of priority of an antecedent mortgage over subsequently filed tax liens."

4. On the other hand in the Brosnan case (U. S. v. Brosnan, 363 U. S. 237), the mortgagee was present with the Government. The fact that Pennsylvania foreclosure procedure required the payment of real estate taxes as an expense of sale was brought to this Court's attention (Main Brief Page 14). Furthermore, Pennsylvania mortgagees have, since that decision continued to pay local taxes from foreclosure sale proceeds without contributing toward the payment of federal tax liens, and the Government has not, since that decision, questioned this Pennsylvania practice.

As to the other matters discussed in the Government's Reply Brief, Respondent rests on its Main Brief.

November, 1962

Respectfully submitted,

JOHN HORACE LITTLE,
Attorney for Buffalo Savings Bank,
45 Main Street,
Buffalo 3, New York.